Supreme Court, U.S.
FILED
SEP 17 2001
CLERK

No. 01-128

IN THE

Supreme Court of the United States

STATE OF CALIFORNIA, *et al.*,

Petitioners,

v.

GEORGE E. SCHULMAN, CHAPTER 7 TRUSTEE,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF IN OPPOSITION

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COUNTER STATEMENT OF STATUTORY PROVISIONS INVOLVED

Petitioners incorrectly assert that this case involves 11 U.S.C. § 106(b). *See* Petition for a Writ of Certiorari ("Pet.") at 2. Elsewhere, however, Petitioners correctly acknowledge that the court of appeals did not rely on that statute in making its Eleventh Amendment holding here. Pet. at 8 n.3. According to one circuit panel, that statute has no effect on Eleventh Amendment sovereign immunity despite the statute's clear terms.[1] *See Arecibo Community Health Care, Inc. v. Puerto Rico*, 244 F.3d 241, 245 (1st Cir. 2001), *panel reh'g granted*, No. 00-1774 (1st Cir. June 7, 2001). As shown below, here the court of appeals applied settled principles of sovereign immunity waiver quite apart from that statute. Like the court of appeals, this Court therefore need not consider the validity or effect of § 106(b).

COUNTER STATEMENT OF THE CASE

The decision of the court of appeals proclaims no new rule of law and conflicts with no decisions of this Court or of any circuit. Following the holdings of two other circuits (the Fourth and Seventh), the Ninth Circuit here held that, for purposes of counter-claims against a State that seek only recoupment to reduce the amount of the State's own claim,

1. The statute provides:

> A governmental unit that has filed a proof of claim in the case is deemed to have waived sovereign immunity with respect to a claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence out of which the claim of such governmental unit arose.

"the state waives its Eleventh Amendment immunity with regard to the bankruptcy estate's claims that arise from the same transaction or occurrence as the state's claim." Pet. App. at 20 (following *Schlossberg v. Maryland (In re Creative Goldsmiths, Inc.)*, 119 F.3d 1140, 1148 (4th Cir. 1997); *Jones v. Yorke (In re Friendship Med. Ctr., Ltd.)*, 710 F.2d 1297, 1301 (7th Cir. 1983)). In making that uncontroversial holding, the court specifically declined to decide the question that Petitioners now ask this Court to address: whether a federal court may infer consent to a claim against the State "that is *not* in the nature of defensive recoupment to the State's claim[.]" Pet. at i (emphasis added).

Rather than resolving that constitutional question, the court of appeals rightly concluded that it "need not be addressed here" because the $4 million claims that Respondent George E. Schulman (the "Trustee") asserts against California actually seek less money than the State's $13 million claims arising from the same transactions or occurrences. Pet. App. at 20-21. As Petitioners actually acknowledged to the court of appeals,

> when a State files a proof of claim, it *does* consent to the bankruptcy court determining a recoupment claim arising out of the "same transaction or occurrence["] as the State's proof of claim and which is only asserted defensively to defeat [or] diminish the State's claim. This principle is recognized in established Eleventh Amendment jurisprudence.

Combined Reply and Cross Appeal Answering Brief of Appellants/Cross-Appellees State of California and California State Water Resources Control Board

and California Underground Storage Tank Cleanup Fund, at 44 (June 10, 1998) (emphasis in original). Despite that concession in June 1998, Petitioners now urge that the court of appeals erred in applying that rule, which supposedly conflicts with this Court's opinions in an earlier case (decided in 1991) and in the later case of *College Savings Bank v. Florida Prepaid Postsecondary Education Expense Board*, 527 U.S. 666 (1999). Pet. at 12-15. Nothing in the proposed Question Presented fairly ~~encom~~passes that mistaken argument.

Petitioners properly do not seek review of the fact-specific holding that the Trustee's claims indeed arise from the same transaction or occurrence that gives rise to some of the State's claims, as required for the Trustee to assert a defensive recoupment claim. At least until the lower courts have adjudicated the merits of California's $13 million claims and the Trustee's counter demands for $4 million, there is no reason to suppose that the amount of the Trustee's claims will go beyond defeating or diminishing the related State claims. Accordingly, there is also no reason to conclude that this Court's review of the proposed Question Presented about hypothetical non-recoupment claims will affect the result of the case. Certiorari to consider that proposed question is therefore unwarranted. *See The SS Monrossa v. Carbon Black Export, Inc.*, 359 U.S. 180, 184 (1959) (dismissing certiorari for review of question that would not change the result).

I. Facts

The court of appeals summarized the claims asserted by and against various California agencies, together with the factual circumstances leading to those claims. *See* Pet. Appendix ("App.") at 4-7. Respondent is the trustee of the

bankruptcy estates of Mr. Gary Lazar, Ms. Divine Grace Lazar, and nine corporations that they owned and controlled (collectively, "the Lazars"). In related criminal proceedings, the Lazars pleaded *nolo contendere* and were sentenced for felony violations of state environmental laws in falsifying required reports of tests for leaks from underground storage tanks ("USTs") for holding gasoline. ER 00267.[2] The district court initially appointed the Trustee to represent the interests of the estates in reorganizing their affairs under Chapter 11 of the Bankruptcy Code; later, when the bankruptcy court converted the proceedings to a liquidation under Chapter 7, that court then appointed the Trustee to administer the estates for the benefit of their creditors. ER 00006.

The Trustee asserted claims against the California Underground Storage Tank Cleanup Fund (the "Fund") and against the California State Water Resources Control Board (the "Water Board"). The Water Board administers the Fund, which consists of fees from filling stations that use USTs. Paying such fees to the Fund is mandatory for obtaining a permit from the Water Board, as required to use a UST in California. Cal. Health & Safety Code § 25299.41. The Lazars (and later, the Trustee) obtained permits to use USTs at filling stations by making payments into the Fund. TRA Tab 7 pp. 1372-73. When a UST at a permitted filling station has leaked, the operator may seek reimbursement from the Fund for costs of cleaning up environmental contamination. Cal. Health & Safety Code § 25299.54. Only the Fund, and not the California treasury, pays such claims:

> Any claim filed against the fund pursuant to this article may be paid only out of the fund.

2. "ER" means Petitioners' Excerpts of Record on Consolidated Appeals, filed in the court of appeals on March 17, 1998.

> This chapter does not authorize the payment by the state of any additional amount with respect to any claim out of any source other than the fund.

Cal. Health & Safety Code § 25299.60(b).

II. Bankruptcy Proceedings

Before seeking bankruptcy protection, the Lazars had submitted roughly $4 million in claims to the Fund for reimbursement of costs incurred to correct leaks from their USTs. ER 0008-09. When the Fund rejected those claims (following the filing of these bankruptcy cases), the Trustee commenced an action against the Water Board and its members in a California trial court. That action sought to compel the Water Board to direct the Fund to pay those claims, together with damages and attorneys fees. ER 00024-25. The Trustee then immediately removed the action to the bankruptcy court, as provided by 28 U.S.C. § 1452(a) (authorizing any party, including a plaintiff, to remove an action to the bankruptcy court).

Meanwhile, the California State Board of Equalization (the "Board of Equalization") submitted proofs of claims seeking payment of at least $13 million that the Lazars allegedly owed the Fund. Pet. App. at 21. The Board of Equalization has statutory authority to file claims for unpaid UST fees for the Fund. *See* Cal. Health & Safety Code § 25299.42; Cal. Rev. & Tax Code §§ 50106, 50108. California also asserted other claims – unrelated to the Fund – seeking $31 million in taxes from the estate. *See* Pet. App. at 21 n.11.

The Water Board and its members moved the bankruptcy court to remand the Trustee's action seeking to compel

reimbursement of UST expenses from the Fund. Among other grounds, they urged that the Eleventh Amendment precludes federal court jurisdiction. The bankruptcy court denied that motion in September 1996. Pet. App. at 93-94. The Water Board appealed.

While the appeal of the Eleventh Amendment ruling was pending in the district court, in August 1997 the bankruptcy court denied the Trustee's request for an order compelling the Water Board to order payment from the Fund. Instead, the court granted the Trustee more limited relief. The court remanded the proceeding to the Water Board to allow the board to receive further evidence and to make an analysis of each claim against the Fund. The court also instructed the Water Board not to impute the Lazars' misconduct to the Trustee. ER 00446-47.[3] Additionally, the court found that the Water Board's procedures had violated the requirements of Fourteenth Amendment due process and the procedural requirements of California administrative law by denying the Trustee an opportunity to see the evidence against the Lazars and to present his own evidence. ER 00440-43. The court also held that the Water Board had failed to explain its reasons for decision, as required by Cal. Code Civ. Proc. § 1094.5, and that there was insufficient evidence to support that decision as a matter of law. ER 00443-45. The Water Board (and its individual members) appealed that order to the district court.

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3. *See generally FDIC v. O'Melveny & Myers*, 61 F.3d 17 (9th Cir. 1995) (per curiam) (holding that, under California equitable principles, a receiver of a debtor's assets is not charged with the debtor's inequitable conduct because the receiver represents the interests of the debtor's creditors – not the debtor itself).

Shortly after the bankruptcy court ordered that relief in August 1997, in September 1997 the district court affirmed the decision that the Water Board was not entitled to Eleventh Amendment immunity. Pet. App. at 95. Petitioners then appealed the Eleventh Amendment ruling to the Ninth Circuit. In December 1997 the district court stayed the order against the Water Board pending the outcome of that Eleventh Amendment appeal. The court also stayed further federal proceedings regarding that order, including the appeal of the merits that was pending in the district court. *See* App., *infra*.

Following the Ninth Circuit's resolution of the Eleventh Amendment issues, the district court has ordered the parites to attend a status conference regarding the Water Board's appeal on the merits. That status conference is scheduled to be held on September 24, 2001.

III. Proceedings in the Court of Appeals

The court of appeals held that California had waived its Eleventh Amendment immunity as to the Trustee's claims against the Water Board when the State's Board of Equalization filed proofs of claims for the Fund in the bankruptcy proceeding. The court concluded that filing such a proof of claim waives the immunity at least with regard to the bankruptcy estate's claims that arise from the same transaction or occurrence. Pet. App. at 20.

The court also acknowledged a disagreement in the circuits regarding whether the scope of such a waiver is limited to counter demands that are in the nature of recoupment, or includes claims seeking an affirmative recovery from the State. Pet. App. at 17-20. The court left that question for another day, noting that it need not resolve

the disagreement in the circuits in this case. Because the estate's claims were slightly over $4 million and the Board of Equalization's proof of claim was at least $13 million in taxes payable to the Fund, the court reasoned, the estate did not seek affirmative recovery beyond the amount of the State's proof of claim. Pet. App. at 20-21.

The court of appeals also held that the Trustee's $4 million claims arose from the same transaction or occurrence as the State's $13 million claims because of the fact that the Trustee sought reimbursement from the Fund for corrective actions taken on underground storage tanks while that the Board of Equalization demanded payments of fees to the Fund. Pet. App. at 24-25. The court addressed and rejected the Water Board's contention that resolution of the Board of Equalization's claims and the Trustee's claims involved wholly separate inquiries. *Id.* at 23. The court noted that both sets of claims concerned the Fund, and both arise out of activities associated with the same bankruptcy case. *Id.* at 23-24. Therefore, the court held, the Trustee's claims against the Water Board were logically related to the proofs of claims filed by the Board of Equalization for unpaid UST fees. Pet. App. at 24.

The Ninth Circuit also addressed – but declined to resolve – the parties' disagreement over whether 11 U.S.C. § 106 precludes Eleventh Amendment immunity in a bankruptcy case like this one. Pet. App. at 25-27. Said the court, "[b]ecause we have determined that the state waived its Eleventh Amendment immunity rendering permissible the estate's counterclaim against the state, we refrain from reaching the constitutionality of sections 106(a) or (b)." Pet. App. at 26-27.

The court of appeals denied Petitioners' request for panel rehearing and rejected their suggestion for en banc consideration. In doing so, the court noted that "no active judge has requested a vote on whether to rehear the matter en banc." Pet. App. at 122.

REASONS FOR DENYING THE WRIT

Resolving the proposed Question Presented about the waiver of immunity as to non-recoupment claims may not affect the outcome of this case. For that reason alone, the Court should deny the request for a writ of certiorari. *See* I, *infra*. Moreover, Petitioners' arguments attacking the holding that the Trustee's claims actually *are* in the nature of recoupment do not support that request for certiorari. *See* II, *infra*. The Court should deny the Petition.

I. Petitioners' Question Presented Is Irrelevant to the Result in this Case.

Contrary to Petitioners' assertions, the record in this case simply does not raise their proposed Question Presented. That question only concerns waiver of immunity as to claims against the State that are "*not* in the nature of defensive recoupment to the State's claim." Pet. at i (emphasis added). But, as the court of appeals correctly determined, the Trustee's federal court claims do not exceed California's related claims. To the contrary, California's claims for fees allegedly owed to the Fund far exceed the Trustee's related claims for reimbursement from the Fund. Currently, therefore, the Trustee's claims *are* recoupment claims – and there is no reason for this Court to decide whether California has waived its Eleventh Amendment immunity as to claims that are *not* recoupment claims.

This Court has long recognized that "recoupment is in the nature of a defense arising out of some feature of the transaction upon which the plaintiff's action is grounded." *Bull v. United States*, 295 U.S. 247, 262 (1935). Because a recoupment claim is defensive in nature, the sovereign is "liable . . . to respond" to such a claim. *Id.* at 263 (rejecting sovereign immunity of the United States).[4] A State waives any Eleventh Amendment immunity to the assertion of defenses when the State voluntarily invokes the jurisdiction of a federal court by asserting a claim in bankruptcy. *Gardner v. New Jersey*, 329 U.S. 565, 573-74 (1947). Not surprisingly, therefore, every Circuit that has addressed the issue has held that a State waives its Eleventh Amendment immunity as to counter demands in the nature of recoupment. *See* Pet. App. at 18; *Schlossberg*, 119 F.3d at 1148; *Jones*, 710 F.2d at 1301.

The Ninth Circuit's holding here does not conflict with *Gardner* or any other decision of this Court or of another Circuit. Petitioners mistakenly argue otherwise by citing to portions of the Ninth Circuit's opinion in which the court of appeals *discussed* – but did not purport to *resolve* – apparently conflicting decisions of other Circuits regarding non-recoupment claims. *See* Pet. at 8 (relying on that discussion to demonstrate the existence of a holding

4. *See also e.g., Miller v. Tony & Susan Alamo Found.*, 134 F.3d 910, 916 (8th Cir. 1998) ("when the United States brings a claim in court, it 'waives immunity as to claims of the defendant which assert matters in recoupment – arising out of the same transaction or occurrence which is the subject matter of the Goverment's suit.' ") (citations omitted); *United States v. Forma*, 42 F.3d 759, 765 (2d Cir. 1994) ("Despite sovereign immunity, 'a defendant may, without statutory authority, recoup on a counterclaim an amount equal to the principal claim.' ") (quoting *United States v. United States Fidelity & Guar. Co.*, 309 U.S. 506, 511 (1940)).

by the Ninth Circuit that would warrant certiorari here); *see also id.* at 4, 11-12 (also asserting that that discussion constitutes the holding of the court of appeals in this case). Those supposedly conflicting decisions are irrelevant here because, as the Ninth Circuit correctly held, the issue of waiver as to non-recoupment claims "need not be addressed here." Pet. App. at 20-21. This is so because the $4 million claims that the Trustee asserts against California actually seek less money than the State's $13 million claims arising from the same transaction or occurrence. *Id.*

To be sure, it is possible that future developments could raise the proposed Question Presented by allowing the Trustee to obtain affirmative relief, beyond a claim in recoupment. This could occur only following a series of events that may or may not come to pass. For example, the Trustee could ultimately obtain affirmative relief: (1) if the bankruptcy court's order granting limited relief on the merits of the Trustee's claims survives the State's current appeal to the district court and any further appellate review by the court of appeals and by this Court; (2) if the Water Board on remand then denies the Trustee's claims against the Fund for a second time; (3) if the Trustee then files (and removes to the bankruptcy court) a new action seeking additional relief; and (4) if the lower federal courts also decide – for reasons entirely apart from such a new action by the Trustee – that California is entitled to collect less from the estate than the amount that the Trustee seeks (or is entitled to collect) from the Fund. If all those events were to occur then it would become necessary to decide whether California is immune from affirmative recovery, beyond recoupment, under the Eleventh Amendment. But in the absence of such developments it would be idle for this Court to decide whether a State's voluntary filing of a bankruptcy claim

allows affirmative relief based on a counter demand arising from the same transaction or occurrence. Instead, deciding that question "can await a day when the issue is posed less abstractly." *The SS Monrosa*, 359 U.S. at 184.

II. Petitioners' Arguments Attacking the Court of Appeals' Standard for Recoupment Claims – the "Same Transaction or Occurrence" Standard – Do Not Warrant Certiorari.

None of the other arguments contained in the Petition support the request for review of Petitioners' proposed Question Presented. In attempting to support that request, they assert that the Ninth Circuit departed from this Court's precedent by applying the "same transaction or occurrence" standard contained in Rule 13(a), Fed. R. Civ. P., to identify a counter demand against the State that is subject to waiver. That Rule 13(a) standard governs the assertion of compulsory counterclaims generally, and Petitioners urge that applying the same standard to identify recoupment claims subject to a waiver of Eleventh Amendment immunity conflicts with *College Savings Bank*, 527 U.S. at 680, and *Oklahoma Tax Commission v. Citizen Band Potawatomi Indian Tribe*, 498 U.S. 505, 509-10 (1991). Pet. at 12-15. According to Petitioners, the "same transaction or occurrence" standard applied by the Ninth Circuit here supposedly "flies in the face of an unbroken line of cases dating back for almost a hundred years demanding the application of a stringent standard." *Id.* at 14. All of those assertions are wrong, and none of them warrants certiorari.

Apart from saying that the court of appeals applied the *wrong* standard, Petitioners do not attempt to identify the *right* standard that supposedly should have been applied to

decide whether the Trustee's claims are recoupment claims. The Ninth Circuit's standard is entirely consistent with precedent that precedes the 1937 adoption of Rule 13(a) and the Federal Rules of Civil Procedure. *See Bull*, 295 U.S. at 262 ("recoupment is in the nature of a defense arising out of some feature of the transaction upon which the plaintiff's action is grounded"). And Petitioners make no effort to reconcile their current challenge to that standard with their acknowledgment to the Ninth Circuit in June 1998 that "when a State files a proof of claim, it *does* consent to the bankruptcy court determining a recoupment claim arising out of the 'same transaction or occurrence[']' as the State's proof of claim" under "established Eleventh Amendment jurisprudence." Petitioners never urged the court of appeals to abandon that "established" standard.

In the absence of exceptional circumstances, this Court does not ordinarily consider arguments that a litigant neglected to make below. *See, e.g., City of Springfield v. Kibbe*, 480 U.S. 257, 258 (1987) (per curiam) (dismissing certiorari). There are no such circumstances here. Nothing in the *College Savings Bank* decision, rendered in June 1999 after Petitioners had filed their June 1998 appellate brief, warrants consideration of Petitioners' new (and erroneous) argument. Petitioners never urged that *College Savings Bank* warranted retracting their statement in the June 1998 brief. In seeking rehearing of the panel decision, Petitioners merely asserted – without relying on *College Savings Bank* – that the "same transaction or occurrence" standard should not have been applied "liberally" to these circumstances.[5]

5. Petition for Rehearing and Suggestion for Rehearing En Banc [FRAP 35, 40], at 10 (Feb. 2, 2001). Petitioners cited *College Savings Bank* once in requesting rehearing, saying only that "the continuing validity of *Gardner* was recently reaffirmed by the Supreme Court in *College Savings Bank*. . . ." *Id.* at 6.

Moreover, nothing in *College Savings Bank* or the earlier decision in *Potawatomi Indian Tribe* impugns the "same transaction or occurrence" standard for identifying recoupment claims. *College Savings Bank*, unlike this case and other cases that involve defensive recoupment, was not "a case in which the State has affirmatively invoked our [federal] jurisdiction." 527 U.S. at 676 (recognizing that affirmatively invoking federal jurisdiction does constitute a waiver of immunity). That case involved the federal copyright statutes and whether a State " 'impliedly' or 'constructively' " waived its immunity, *id.*, by voluntarily electing to engage in federally regulated conduct where Congress has provided that doing so will subject the State to suit, *id.* at 884. *College Savings Bank* has nothing whatsoever to do with recoupment claims. Likewise, *Potawatomi Indian Tribe* also did not involve recoupment claims. The sovereign tribe in that case did not assert any claim for money, and for this reason no counter demand seeking money could have operated as a defensive recoupment claim. The tribe sought only an injunction against being made to *pay* money; it did not seek to *collect* any money. *See* 498 U.S. at 507.

Petitioners properly do not seek review of the case-specific holding that, under the "same transaction or occurrence" standard, California has waived its Eleventh Amendment immunity as to the Trustee's recoupment claims here. This Court rarely reviews "the misapplication of a properly stated rule of law." Sup. Ct. R. 10. Nevertheless, in seeking review of their proposed Question Presented, Petitioners urge that the Ninth Circuit erred by applying that standard in a "liberal" way. Pet. at 8; *see also id.* at 13 (contending that the Ninth Circuit "utilized an 'increasingly liberal' test"). Petitioners are wrong. The court of appeals applied the legal standard in a way that is entirely consistent

with this Court's 1935 analysis of sovereign immunity in *Bull*, 295 U.S. at 262-63 (holding that the government's claim for income taxes was sufficiently related to the taxpayer's counter demand for a refund of estate tax payments because both claims involved taxation of proceeds from a single fund). In applying that correctly-stated legal standard, the court of appeals merely acknowledged that a 1966 decision had said that the term " 'transaction . . . gets an increasingly liberal construction.' " Pet. at 24 (quoting *Albright v. Gates*, 362 F.2d 928, 929 (9th Cir. 1966)). As *Albright* correctly observed over three decades ago, "[t]wo bundles of facts seldom are identical for comparing 'transactions,' and so close judgments must be made from time to time." 362 F.2d at 929 (deciding the scope of "ancillary" federal jurisdiction over claims against non-diverse parties). The Ninth Circuit's judgment of the facts in this particular case does not warrant certiorari.

Quite apart from the lack of exceptional circumstances to justify considering Petitioners' new and erroneous argument that the Ninth Circuit supposedly departed from this Court's century-old recoupment standard, that argument also is not before the Court for another reason. "Only the questions set out in the petition, or fairly included within them, will be considered by the Court." Sup. Ct. R. 14.1(a). Here, the Question Presented only concerns whether to find a waiver of immunity as to a claim "that is *not* in the nature of defensive recoupment to the state's claims." Pet. at i (emphasis added). Nothing in that question fairly includes the standard for identifying claims that *are* in the nature of defensive recoupment. "A question which is merely 'complementary' or 'related' to the question presented in the petition for certioari is not 'fairly included therein.' " *Izumi Seimitsu Kogyo Kabushiki Kaisha v. U.S. Philips Corp.*, 510

U.S. 27, 31-32 (1993) (per curiam). Needless to say, merely arguing such an issue in the text of the petition, as Petitioners do here, does not suffice. *Izumi*, 510 U.S. at 32 n.5. Because Petitioners' arguments about the standard for identifying recoupment claims are – at best – "complementary" or "related" to the question of waiver as to non-recoupment claims, the Court will not consider the Ninth Circuit's purported errors in stating and in applying that standard.

CONCLUSION

The Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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